88-1474 (1)

No.

In the Supreme Court of the United States

OCTOBER TERM, 1988

UNITED STATES OF AMERICA, PETITIONER

v.

THE GOODYEAR TIRE AND RUBBER COMPANY AND AFFILIATES

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

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QUESTION PRESENTED

Whether the term "accumulated profits" in the foreign tax credit provisions of Section 902 of the Internal Revenue Code means income or profits as defined by the tax law of the United States or, instead, as defined by the tax law of a foreign country.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

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*PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT*

The Solicitor General, on behalf of the United States of America, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Federal Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra,* 1a-8a) is reported at 856 F.2d 170. The opinion of the Claims Court (App., *infra,* 9a-28a) is reported at 14 Cl. Ct. 23.

JURISDICTION

The judgment of the court of appeals (App., *infra,* 29a) was entered on August 31, 1988. A petition for rehearing was denied on November 8, 1988 (App., *infra,* 31a). On January 25, 1989, the Chief Justice extended the time within which to petition for a writ of certiorari to and including March 8, 1989. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Sections 316, 901, and 902 of the Internal Revenue Code of 1954 (26 U.S.C.) and Section 1.902-3 of the Treasury Regulations on Income Tax (26 C.F.R.), as in effect for 1970 and 1971, are set forth in pertinent part in a statutory appendix (App., *infra,* 32a-35a).

STATEMENT

1. This case involves the foreign tax credit applicable to the taxation of dividend income received by a domestic corporation from its foreign subsidiary. When a foreign subsidiary delivers all or part of its profits to its parent, that money generally is taxable to the parent as a dividend under the provisions of Sections 301 and 316 of the Internal Revenue Code.[1] If those profits have already been subjected to income tax by the foreign country where they were earned, simple taxation as a dividend by the United States will result in double taxation of the same income. Accordingly, Sections 901(a) and 902(a)(1) of the Code allow the parent (if it owns at least 10% of the voting stock of the foreign subsidiary) to take an "indirect" or "deemed paid" credit against its United States income tax to reflect income tax paid by the subsidiary to a foreign country.

The situation is complicated somewhat when, in a particular year, the foreign subsidiary does not deliver all of its profits to its parent, but instead retains some of the profits and adds them to surplus. In that event, giving the parent a full credit for all of the foreign income tax paid by the subsidiary would be a windfall because the parent is not receiving all of the subsidiary's profits as a dividend

[1] Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as in effect during 1970 and 1971, the years at issue (the Code or I.R.C.).

subject to United States income tax. Therefore, the Code allows the parent to take a credit for only a prorated portion of the foreign income taxes paid by the subsidiary. See generally *American Chicle Co.* v. *United States,* 316 U.S. 450 (1942).

Section 902(a)(1) provides for the computation of the allowable credit as follows: "to the extent such dividends are paid by such foreign corporation out of accumulated profits," the parent is "deemed to have paid the same proportion of any income * * * taxes paid * * * by such foreign corporation to any foreign country * * * on or with respect to such accumulated profits, which the amount of such dividends * * * bears to the amount of such accumulated profits in excess of such * * * taxes." In other words, the allowable prorated credit is computed by multiplying the foreign taxes paid by a fraction – the ratio of the dividends paid to the subsidiary's (after-tax) accumulated profits. This computation is illustrated by the following equation (see App., *infra,* 4a, 15a n.6):[2]

$$\text{Foreign taxes paid} \times \frac{\text{Dividends}}{\text{Accumulated profits minus foreign taxes}} = \S\ 902 \text{ credit}$$

The issue in this case is the meaning of the term "accumulated profits" – specifically, whether it refers to the

[2] This Court described this equation in narrative form in *American Chicle,* stating that the foreign taxes are multiplied by a fraction, of which "[t]he numerator is the dividends received by the parent [and] [t]he denominator is the 'accumulated profits' of the subsidiary" (316 U.S. at 452); the statute was later amended to require the subtraction of foreign taxes from the denominator. The operation of the proportional credit can be illustrated by some simple examples. If a foreign subsidiary earns $100 of profits, pays $20 in foreign taxes and distributes the remaining $80 to its parent as a dividend, the parent is entitled to the full $20 credit ($20 × $80/($100 – $20)). If, however, the subsidiary distributes only $40 of its after-tax profits to its parent,

subsidiary's profits as computed under United States tax law or under the tax law of the foreign country.[3]

2. Respondent is an affiliated group of domestic corporations that file consolidated federal income tax returns. The parent of the group (Goodyear U.S.) owns all of the stock of a British subsidiary (Goodyear U.K.) that does not join in the consolidated return. During 1970 and 1971 the subsidiary reported net income on its British tax returns, paid taxes to Britain on that income, and distributed dividends to its parent. On its 1973 British tax

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the allowable credit will be halved to $10 ($20 × $40/($100 − $20)). The allowable credit can also be affected by a change in the denominator of the equation. If the subsidiary distributes the same $80, but the "accumulated profits" are determined in a different manner and found to be $180, the allowable credit will also be halved to $10 ($20 × $80/($180 − $20)).

[3] The statutory definition of "accumulated profits" does not specifically address this question. It defines the term for purposes of Section 902 as "the amount of [the corporation's] gains, profits, or income computed without reduction by the amount of the income * * * taxes imposed on or with respect to such profits or income" (I.R.C. § 902(c)(1)). The definition goes on to provide that the Commissioner has the "full power to determine from the accumulated profits of what year or years such dividends were paid," generally "treating dividends as having been paid from the most recently accumulated gains, profits, or earnings" (*ibid.*). This latter provision reflects the fact that the credit is to be computed by considering the subsidiary's accumulated profits on an annualized basis. A dividend payment is allocated first to the accumulated profits of the most recent year and then, if those profits are insufficient to cover the amount of the dividend, to the profits of the next most recent year, and so forth. The credit is then computed separately for each year to which the dividend is traced by multiplying the foreign tax paid for that year by the appropriate fraction. The sum of those separate annual computations yields the Section 902 credit for the particular dividend. See *H.H. Robertson Co.* v. *Commissioner*, 59 T.C. 53, 78-83 (1972), aff'd, 500 F.2d 1399 (3d Cir. 1974); *General Foods Corp.* v. *Commissioner*, 4 T.C. 209, 215 (1944).

return, however, the subsidiary reported a loss (attributable to accelerated depreciation and special inventory adjustments) that it carried back to offset virtually all of its income for 1971 and part of its income for 1970. As a result of this loss carryback, Britain refunded almost all of the income tax paid for 1971 and part of the tax paid for 1970. The 1973 loss deductions, although recognized under British law, are not allowed in computing income under the Internal Revenue Code. App., *infra,* 1a-2a, 10a-11a.

On the consolidated tax returns for 1970 and 1971, respondent claimed Section 902 foreign tax credits with respect to the dividends received from the British subsidiary. For purposes of computing the prorated credit, respondent determined the subsidiary's "accumulated profits" based on the British definition of taxable income, thereby eliminating almost all of the subsidiary's accumulated profits for 1971 and reducing them for 1970. This treatment resulted in a substantially larger Section 902 credit for respondent in 1970 and 1971, and therefore a correspondingly smaller United States income tax liability, than if respondent had computed "accumulated profits" based on the United States definition of taxable income. App., *infra,* 11a, 15a-16a.[4] The Commissioner, based on his determination that the subsidiary's "accumulated profits" must be computed under principles of United States law, asserted deficiencies in respondent's income tax of $323,654 for 1970 and $237,616 for 1971. Respondent paid the deficiencies and, after its administrative refund claim was denied, brought this refund action in the Claims Court. *Id.* at 2a-3a & n.3, 11a-12a, 23a-24a.

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[4] The tax advantage was achieved by respondent in two related ways. First, the reduction in accumulated profits in 1970 correspond-

3. On cross-motions for summary judgment, the Claims Court held for the government, ruling that "accumulated profits" in Section 902 means income or profits as defined by the Internal Revenue Code, not by the tax law of a foreign country (App., *infra,* 9a-28a). The court found that this conclusion was strongly supported by Tax Court precedent (*id.* at 16a-19a) and by the language (*id.* at 19a-21a), purpose (*id.* at 22a-25a), and consistent administrative interpretation (*id.* at 25a-26a) of Section 902. With respect to the statute itself, the court explained that the dividends in the numerator of the Section 902 fraction are undeniably computed under United States law (App., *infra,* 20a) and the "accumulated profits" in the denominator are "the fund from which the dividends are paid" (*id.* at 21a). Therefore, the court concluded, it would introduce an inconsistency that would impair the proper functioning of the allocation formula if United

ingly increased the ratio of dividend to profits for that year, thereby allowing respondent to take a credit for a higher proportion of the 1970 British tax. Second, because the accumulated profits for 1971 were virtually eliminated, they were not sufficient to cover the dividend paid in that year. Accordingly, under the annualization principle of Section 902 (see note 3, *supra*), part of the 1971 dividend was attributed to profits earned in preceding years going back to 1968. Because the foreign taxes in those years were much higher than the almost nonexistent tax of 1971, respondent's allowable Section 902 credit was increased. App., *infra,* 23a-24a; C.A. App. 68-69. By contrast, because the 1973 loss and resulting carryback are not allowable under the Internal Revenue Code, they do not act to reduce the subsidiary's "accumulated profits" if those profits are computed under United States law. Without that adjustment unique to British law, the profits for 1971 are adequate to cover the dividend paid that year and therefore the 1970 and 1971 dividends can simply be treated as having been derived from the accumulated profits for the years of distribution. Because the foreign tax paid in those years was relatively small, the Section 902 credit for those years is correspondingly small. *Ibid.*

States law is not also used to compute the profits in the denominator (*ibid.*).

Based on the legislative history, the Claims Court identified three principal purposes of the Section 902 credit: (1) to provide equal treatment for unincorporated foreign branches and foreign subsidiaries; (2) to eliminate double taxation; and (3) to limit the allowable credit for foreign taxes paid by a subsidiary (when a portion of the profits is not distributed as a dividend). App., *infra,* 23a. The court found that its interpretation "effectuates congressional intent" (*ibid.*) in furthering these policies whereas respondent's interpretation would frustrate them. In particular, the court rejected respondent's contention that defining "accumulated profits" in terms of United States law would lead to double taxation in this case. The court explained that the relatively small credit that respondent receives under the court's interpretation is a direct result of the fact that its subsidiary paid very little British income tax in 1970 and 1971. *Id.* at 24a. The court concluded (*ibid.*): "To not recognize this fact as [respondent] urges would eviscerate the very purpose of the pro-rata credit and permit [respondent] a substantial windfall in avoiding other taxes with the phantom taxes deemed paid."

Finally, the court found that its holding was supported by the longstanding administrative construction embodied in Treas. Reg. § 1.902-3(c)(1) (1971 ed.). That regulation explicitly equates the term "accumulated profits" in Section 902 with the "earnings and profits" that are the source of dividends under Section 316 of the Code and that undeniably are computed under United States law. The court concluded that this unambiguous administrative construction is "consistent with the purposes enunciated by Congress when enacting the indirect tax credit legislation" (App., *infra,* 26a).

4. The court of appeals reversed (App., *infra*, 1a-8a). The court held that the "plain meaning" of Section 902 requires the conclusion that "accumulated profits" must be determined by applying the tax law of the foreign country (*id.* at 6a). The court stated that the text of Section 902(a)(1) describes the creditable foreign taxes as those paid "on or with respect to the accumulated profits of such foreign corporation," and that Section 902(c) uses similar language (App., *infra*, 6a (quoting the 1982 version of Section 902) (emphasis deleted)). The court concluded from this phrasing that "accumulated profits" must be "the actual basis on which the foreign sovereign assesses tax liability," *i.e.*, foreign taxable income as determined by foreign revenue laws (*ibid.*). The court also concluded that its interpretation is necessary to implement the statutory goal of preventing double taxation, stating that determining "accumulated profits" under United States law would defeat this goal by "severing the relationship" between the foreign taxes paid by the subsidiary and the accumulated profits with respect to which those taxes are paid (*ibid.*). The court rejected the Tax Court precedent relied upon by the Claims Court as "fail[ing] to address the controversy raised in the instant case" (*id.* at 7a), and it did not discuss at all the settled administrative construction that is directly contrary to its decision.

REASONS FOR GRANTING THE PETITION

The court of appeals has erroneously held that Congress intended the term "accumulated profits" in Section 902 of the Code to mean a foreign country's definition of taxable income. The court's decision thus overturns the construction of the statute that has long been settled. Moreover, the decision is seriously antithetical to the purposes of the statute and will reintroduce some of the disparities in tax treatment that it was designed to eliminate. And this major disruption of the statutory scheme rests on an unusually weak foundation—a "plain meaning" discussion that manifestly misunderstands the operation of the Section 902 credit.

While the court of appeals' decision involves a technical issue, it will have enormous deleterious consequences on the public fisc and on the fair administration of the tax laws if it is permitted to stand. Because the decision below is by a court of nationwide jurisdiction, the error places the Treasury in a whipsaw posture. Taxpayers whose particular situation makes it advantageous for them to invoke the erroneous construction below can arrange to have their case heard in the Claims Court where the decision below will be binding precedent. Other taxpayers for whom the Federal Circuit's erroneous construction is not advantageous can continue to use the previously well-settled rule that accumulated profits are computed under United States law. Because this issue typically involves contested tax liabilities of considerable magnitude, the decision below creates the opportunity for a substantial windfall for many multinational corporations. It is therefore appropriate for this Court to grant certiorari to correct the error of the court below and establish uniformity in the application of the indirect foreign tax credit.

1. The court of appeals in this case has overturned, with little more than perfunctory analysis, the well-settled construction of an important statute governing the taxation of multinational corporations. For more than 50 years, the Treasury has consistently interpreted accumulated profits using principles of United States taxation. In 1933, the Commissioner took the position that "the amount of the accumulated profits" is "based as a fundamental principle upon all income of the foreign corporation available for distribution to its shareholders, *whether such profits be taxable by the foreign country or not.*" I.T. 2676, XII-1 C.B. 48, 50 (1933) (emphasis added).

Accordingly, he ruled that, in order to determine "accumulated profits" under the predecessor of Section 902, the income on which the foreign taxation of a subsidiary is based must be adjusted for special deductions unique to foreign law that do not reduce the subsidiary's income or surplus available for the distribution of dividends under United States law (XII-1 C.B. at 51).

This position was embodied in a formal regulation in 1965. Treas. Reg. § 1.902-1(e) (originally promulgated as Treas. Reg. § 1.902-3(c)(1) (1965 ed.)) defines the accumulated profits of a foreign subsidiary for a taxable year as "the sum of (1) the *earnings and profits* of such corporation for such year, and (2) the foreign income taxes imposed on or with respect to the gains, profits and income to which such earnings and profits are attributable" (emphasis added). "Earnings and profits" is an established term that represents the source of payments treated as dividends under Section 316 of the Code, and there is no doubt that its calculation is based upon the rules for determining United States taxable income. See, *e.g.*, I.R.C. § 312; B. Bittker & J. Eustice, *Federal Income Taxation of Corporations and Shareholders,* ¶ 7.03 (5th ed. 1987). The Commissioner has explained that "accumulated profits" under Section 902 are similar to "earnings and profits" under Section 316 because the term "dividends" has precisely the same meaning in both sections and "both 'accumulated profits' and 'earnings and profits' denote the same source from which 'dividends' are paid" (Rev. Rul. 63-6, 1963-1 C.B. 126, 128). The Commissioner has consistently adhered to this position. See, *e.g.*, Rev. Rul. 87-72, 1987-2 C.B. 170; Rev. Rul. 87-14, 1987-1 C.B. 181.

Although this established administrative interpretation has, for the most part, not been challenged in litigation, it

has been approved by the Tax Court on two occasions. In its reviewed decision in *Steel Improvement & Forge Co.* v. *Commissioner,* 36 T.C. 265, 276-282 (1961), rev'd on other grounds, 314 F.2d 96 (6th Cir. 1963), the Tax Court held that a foreign subsidiary's accumulated profits under Section 902 were not reduced by a loss and carryback that were allowed by Canadian law but would not be allowed under United States tax law, stating that "the accumulated earnings and profits from which the dividends are paid are to be determined under American rather than foreign law" (36 T.C. at 277). In *Champion International Corp.* v. *Commissioner,* 81 T.C. 424, 446-447 (1983), the Tax Court discussed *Steel Improvement* and reaffirmed this holding. The court unequivocally stated that "[a]ccumulated profits are determined under American law rather than foreign law" (*id.* at 447).

The leading treatises and commentaries on the foreign tax credit likewise have concluded that accumulated profits must be computed under concepts of United States taxation.[5] And Congress, in the course of amending the foreign tax credit provisions in other respects in 1986 (see pages 24-25, *infra*), explicitly noted its recognition that, under existing law, "accumulated profits * * * are generally calculated in accordance with the principles governing the calculation of earnings and profits for U.S. tax purposes" (S. Rep. No. 313, 99th Cong., 2d Sess. 299 (1986)). The Senate Report cited *Steel Improvement,* Treas. Reg. § 1.902-1(e), and Rev. Rul. 63-6, *supra,* as evidencing this

[5] See 1 E. Owens & G. Ball, *The Indirect Credit* 161-162 (1975); E. Owens, *The Foreign Tax Credit* 119-121 (1961); B. Bittker & J. Eustice, *Federal Income Taxation of Corporations and Shareholders* ¶ 17.11, at 17-44 (5th ed. 1987); Schoenfeld, *Some Definitional Problems in the Deemed Paid Foreign Tax Credit of Section 902: "Dividends" and "Accumulated Profits"*, 18 Tax L. Rev. 401, 407-421 (1963); Eigner, *The Foreign Tax Credit,* 39 Taxes 724, 729-730, 736 (1961).

settled proposition. S. Rep. No. 313, *supra*, at 299 n.6. See also H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. 841 (1984) (for purposes of the "deemed paid" credit, "accumulated profits are essentially equivalent to earnings and profits").

This established interpretation of "accumulated profits" accords with the general principle concerning the construction of the foreign tax credit provisions that was laid down by this Court in *Biddle* v. *Commissioner,* 302 U.S. 573 (1938). The Court there stated that, because the subject matter of the Code is the computation of United States income tax, it should be presumed that Congress intended that "its own criteria" would be used to interpret the terms of the statute (*id.* at 578). The Court explained that this presumption could be rebutted only if "the statute, by express language or necessary implication, makes the meaning of the phrase * * * depend upon its characterization by the foreign statutes" (*ibid.*). Under this principle, the Court in *Biddle* held that the phrase "income taxes paid or accrued" in a predecessor to Section 901(b)(1) was to be interpreted in accordance with United States tax law, finding "nothing in [the statute's] language to suggest that in allowing the credit for foreign tax payments, a shifting standard was adopted by reference to foreign characterizations and classifications of tax legislation" (*id.* at 578-579).

2. a. The court of appeals departed from the well-established interpretation of Section 902 in a remarkably casual fashion. Despite this Court's repeated admonition that Treasury regulations, "if found to 'implement the congressional mandate in some reasonable manner,' must be upheld" (*National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472, 476 (1979), quoting *United States* v. *Cartwright,* 411 U.S. 546, 550 (1973)), the court of appeals did not discuss, or even acknowledge, the applicable

regulation. The court barely adverted (see App., *infra,* 6a) to this Court's decisions construing the foreign tax credit. And the court dismissed the Tax Court's clear approval of the interpretation embodied in the regulations by concluding that the Tax Court has misconstrued its own precedent (*id.* at 7a-8a). Instead, the court relied almost entirely on what it found to be the "plain meaning" of Section 902. The court's analysis, however, is based on a faulty reading of the text of the statute. Moreover, the court's holding is clearly antithetical to the statutory design and purposes.

The court of appeals' holding rests almost exclusively on one phrase in Section 902 read in isolation. Because the statute refers to foreign taxes paid "on or with respect to * * * accumulated profits" (§ 902(a)(1); see also § 902(c)(1)), the court held that "accumulated profits" must be defined as the "actual basis on which the foreign sovereign assesses tax liability," *i.e.*, taxable income computed under foreign law (App., *infra,* 6a). But this reasoning, which in any event hardly represents a "plain meaning" construction, completely loses its force when the entire statute is examined. Section 902(a)(1) goes on to refer to the "dividends * * * paid by such foreign corporation out of accumulated profits." It is these "dividends" that are subjected to United States income tax, and Section 316 of the Code makes clear that payments are treated as "dividends" to the extent that their source is "earnings and profits".[6] Hence, the text of Section 902 essentially identifies "accumulated profits" with "earnings and profits." Even the court below recognized "the undisputed and well-settled fact that 'the determination of a foreign

[6] If a distribution to shareholders exceeds the available "earnings and profits," both current and historic, the excess is not a dividend, but rather a return of capital. See I.R.C. § 301(c).

corporation's *earnings and profits* * * *, for purposes of the imposition of the U.S. tax, is to be made by the application of U.S. tax principles' " (App., *infra*, 7a, quoting *H.H. Robertson Co.* v. *Commissioner*, 59 T.C. 53, 69 (1972), aff'd, 500 F.2d 1399 (3d Cir. 1974)). Thus, the court of appeals' approach to parsing the statute equally points to the conclusion that "accumulated profits" are computed under United States law.

It is therefore apparent that the "plain meaning" of the statute does not provide an adequate basis for the court of appeals' decision. Indeed, if any "plain meaning" can be gleaned from examination of the statute alone, it is the meaning suggested by the general principle of *Commissioner* v. *Biddle*, *supra*—namely, that provisions of the Internal Revenue Code governing the computation of domestic income taxes are to be interpreted in accordance with United States law in the absence of some express indication to the contrary. When one examines the purposes of Section 902 and the way in which the credit is designed to work, it becomes manifest that the amount of "accumulated profits" is to be determined in accordance with United States tax law.

b. The term "accumulated profits" was introduced into the ratio for computing the indirect foreign tax credit by Section 238(e) of the Revenue Act of 1921, ch. 136, 42 Stat. 259. As this Court explained in *American Chicle Co.* v. *United States*, 316 U.S. 450, 453-454 (1942), this change was made because the original version, which computed the credit on the basis of the ratio between dividends and total taxable income, did not adequately achieve its purpose of preventing double taxation. "The difficulty with it was that it did not relate the credit to the accumulated profits or surplus of the subsidiary *out of which the dividends were paid*" (*id.* at 453 (emphasis added)). For example, if the subsidiary made no profit and paid no foreign tax in a

particular year, yet distributed a dividend out of surplus, the pre-1921 statute would not have allowed any credit because there was no taxable income in the year in which the dividend was distributed. The new statute was designed "to permit identification of the accumulated profits out of which the dividend might have been paid and to give credit for a proportion of the subsidiary's taxes attributable to such accumulated profits" (*id.* at 454).

Since the correct computation of the credit requires identification of the profits out of which the dividend was paid, which is a concept defined under United States law (see I.R.C. §§ 312, 316; page 12, *supra*), the Claims Court correctly stated that the interpretation subsequently adopted by the court of appeals introduces an "[a]lgebraic [in]consistency" (App., *infra*, 21a) that prevents the Section 902 credit from working properly to preclude double taxation. The goal of the prorated credit is to apportion the foreign tax to the domestic parent based on the "dividends" that it receives from the subsidiary and must treat as taxable income on its United States return. Accordingly, the term "dividends" in the numerator of the Section 902 fraction plainly has the meaning assigned to it by Section 316 of the Internal Revenue Code. The "accumulated profits" in the denominator simply represent the fund from which the dividends are paid; the total accumulated profits are the pool of potential dividends, *i.e.*, the maximum earnings of the subsidiary that would be taxed as dividends if distributed to the parent. Just as United States tax concepts determine whether the actual distribution made by the subsidiary is taxed as a dividend, so too they must determine what is the maximum amount of the subsidiary's earnings that could be distributed as a dividend, *i.e.*, the "accumulated profits." The determination of "accumulated profits" under principles of United

States law thus is required to correlate the Section 902 fraction's numerator (the actual dividends) with its denominator (the potential dividends), thereby providing a coherent ratio by which to compute the share of foreign tax that has been borne by the distributed portion of the subsidiary's total earnings.

The extent to which the court of appeals' interpretation of Section 902 disrupts the proper functioning of the credit is illustrated by the simple example provided earlier (see note 2, *supra*). If the foreign subsidiary earns $100 of profit, pays $20 in foreign taxes and distributes the remaining $80 to its parent as a dividend, the parent is entitled to the full $20 credit ($20 × $80/($100 − $20)). This result is obviously correct; when the subsidiary distributes to the parent all of the funds available for dividends, the parent should be entitled to a credit for all of the foreign taxes paid. This result is achieved, however, only if "accumulated profits" are defined under United States law. If, on the same facts, the foreign country does not allow an $80 deduction that is permitted by United States law and therefore the "accumulated profits" determined under foreign law would be $180, application of the court of appeals' interpretation would halve the parent's credit to $10 ($20 × $80/($180 − $20)), even though the parent took into income 100% of the amount of earnings available for distribution as a dividend. Thus, the court of appeals' approach, in divorcing the credit from the fund out of which the dividends are paid, would reintroduce some of the "eccentric results" that the 1921 legislation was designed to eliminate (see *American Chicle Co.* v. *United States*, 316 U.S. at 453).

The above analysis is reflected and strongly supported by this Court's decision in *American Chicle* itself. The

court there construed the very phrase upon which the court of appeals placed reliance—taxes "paid * * * with respect to the accumulated profits" of the subsidiary (see 316 U.S. at 451). At that time, the predecessor of Section 902 defined "accumulated profits" as after-tax profits. The question presented was not the meaning of that term, but rather the meaning of the entire "taxes paid" clause—whether the foreign tax that is the starting point for computing the credit should be the total tax paid on the subsidiary's pre-tax profits or instead a smaller amount that reflects the proportion of total tax *attributable to the after-tax profits.* The Court agreed with the government that Congress had intended the latter result.[7] The Court explained (*id.* at 452-453):

> If, as admitted, the purpose is to avoid double taxation, the statute, as written, accomplishes that result. The parent receives dividends. Such dividends, not its

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[7] The nature of the dispute in *American Chicle* is best explained with the help of an example. If the subsidiary had $200 in income and paid a foreign tax of $20, it would have had $180 in "accumulated profits" as then defined. If the subsidiary had distributed the $180 as a dividend, the taxpayer's position in *American Chicle* was that it would be entitled to a $20 credit. The Court rejected this position, however, finding that $20 was the amount of taxes paid on the subsidiary's pre-tax income, not the amount paid "with respect to the accumulated profits" of $180. Thus, under the so-called *American Chicle* limitation, the taxpayer was entitled to a credit of only $18, the foreign tax apportionable to the $180 of accumulated profits.

In 1962, Congress amended Section 902 to accomplish a similar result by redefining "accumulated profits" as the pre-tax income of the subsidiary, but at the same time adding Section 78 of the Code, which requires the parent to take into income ("gross-up") the amount of the allowable foreign tax credit. Under that approach, applicable for the tax years at issue in this case, the credit is first computed without the *American Chicle* limitation, but this change is offset by treating the credit itself as income to the parent. See, *e.g.*, *H.H. Robertson* v. *Commissioner*, 59 T.C. at 77 & n.13. This adjustment is necessary to achieve maximum parity between the tax treatment of foreign

subsidiary's profits, constitute its income to be returned for taxation. The subsidiary pays tax on, or in respect of, its entire profits; but, since the parent receives distributions out of what is left after payment of the foreign tax, that is, out of what the statute calls "accumulated profits," it should receive a credit only for so much of the foreign tax paid as relates to or, as the Act says, is paid upon, or with respect to, the accumulated profits.

The lesson of *American Chicle* is that the touchstone for computing the prorated Section 902 credit is the maximum amount of the subsidiary's earnings available for distribution as dividends. Amounts that are not available for distribution as dividends are not relevant in making the proration. Thus, in *American Chicle*, the amount of the subsidiary's earnings paid as foreign taxes would never be available for distribution as dividends; hence, the amount of foreign tax attributable to those earnings was not creditable. Correspondingly here, the amount of the subsidiary's income computed under foreign law principles does not define the maximum amount available for distribution as a dividend. It is that latter amount, the "earnings and profits" computed under United States law, that must be the benchmark for computing the allowable portion of the credit.

In sum, the statutory design is that the allowable credit shall be the proportion of the foreign tax that the dividends actually received bear to the potential dividends. That approach confines the credit to the amount necessary to prevent double taxation. It can be implemented only if "accumulated profits" are computed under United States law so that they reflect potential dividends.

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branches and foreign subsidiaries. See pages 19-22, *infra*; B. Bittker & J. Eustice, *supra*, ¶ 17.11, at 17-45 to 17-47.

By contrast, the court of appeals here fallaciously reasoned that its interpretation furthers the statutory purpose of preventing double taxation (App., *infra*, 6a-7a). But determining "accumulated profits" under United States law does not prevent "tax payments already made to the foreign country" from being "fully recoverable as tax credits," as the court of appeals claimed (*ibid.*). The fact that respondent's credit on its 1970 and 1971 tax returns is reduced when accumulated profits are determined under United States law is a consequence, not of double taxation, but of the fact that respondent's subsidiary paid little foreign tax in those years as a result of the special loss and carryback available under British law. Because most of the subsidiary's profits carried out by the dividend distribution had escaped British taxation owing to the loss carryback, they were taxed for the first time, not the second, when included in respondent's United States income. What respondent is seeking is a tax credit based on "phantom taxes" that the British subsidiary was able to escape paying to Britain because of the loss carryback; the Claims Court correctly characterized that result—adopted by the court of appeals—as a "substantial windfall" to respondent (App., *infra*, 24a).

c. As the Claims Court found (App., *infra*, 23a, 24a-25a), the interpretation subsequently adopted by the court of appeals also undermines one of the primary congressional policies that pervades the foreign tax credit provisions—namely, to provide companies, like respondent, that operate their foreign business through a separately incorporated foreign subsidiary with the same relief from double taxation that is provided to companies that operate through a foreign branch. A foreign branch is simply a part of the larger domestic company, and all of its income earned in a foreign country is automatically income to the

> subsidiary's profits, constitute its income to be returned for taxation. The subsidiary pays tax on, or in respect of, its entire profits; but, since the parent receives distributions out of what is left after payment of the foreign tax, that is, out of what the statute calls "accumulated profits," it should receive a credit only for so much of the foreign tax paid as relates to or, as the Act says, is paid upon, or with respect to, the accumulated profits.

The lesson of *American Chicle* is that the touchstone for computing the prorated Section 902 credit is the maximum amount of the subsidiary's earnings available for distribution as dividends. Amounts that are not available for distribution as dividends are not relevant in making the proration. Thus, in *American Chicle*, the amount of the subsidiary's earnings paid as foreign taxes would never be available for distribution as dividends; hence, the amount of foreign tax attributable to those earnings was not creditable. Correspondingly here, the amount of the subsidiary's income computed under foreign law principles does not define the maximum amount available for distribution as a dividend. It is that latter amount, the "earnings and profits" computed under United States law, that must be the benchmark for computing the allowable portion of the credit.

In sum, the statutory design is that the allowable credit shall be the proportion of the foreign tax that the dividends actually received bear to the potential dividends. That approach confines the credit to the amount necessary to prevent double taxation. It can be implemented only if "accumulated profits" are computed under United States law so that they reflect potential dividends.

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branches and foreign subsidiaries. See pages 19-22, *infra*; B. Bittker & J. Eustice, *supra*, ¶ 17.11, at 17-45 to 17-47.

By contrast, the court of appeals here fallaciously reasoned that its interpretation furthers the statutory purpose of preventing double taxation (App., *infra*, 6a-7a). But determining "accumulated profits" under United States law does not prevent "tax payments already made to the foreign country" from being "fully recoverable as tax credits," as the court of appeals claimed (*ibid.*). The fact that respondent's credit on its 1970 and 1971 tax returns is reduced when accumulated profits are determined under United States law is a consequence, not of double taxation, but of the fact that respondent's subsidiary paid little foreign tax in those years as a result of the special loss and carryback available under British law. Because most of the subsidiary's profits carried out by the dividend distribution had escaped British taxation owing to the loss carryback, they were taxed for the first time, not the second, when included in respondent's United States income. What respondent is seeking is a tax credit based on "phantom taxes" that the British subsidiary was able to escape paying to Britain because of the loss carryback; the Claims Court correctly characterized that result—adopted by the court of appeals—as a "substantial windfall" to respondent (App., *infra*, 24a).

c. As the Claims Court found (App., *infra*, 23a, 24a-25a), the interpretation subsequently adopted by the court of appeals also undermines one of the primary congressional policies that pervades the foreign tax credit provisions—namely, to provide companies, like respondent, that operate their foreign business through a separately incorporated foreign subsidiary with the same relief from double taxation that is provided to companies that operate through a foreign branch. A foreign branch is simply a part of the larger domestic company, and all of its income earned in a foreign country is automatically income to the

larger domestic company and subject to taxation on its United States income tax return. Since 1918, the domestic company has been entitled to take a credit against its United States income tax for the foreign income taxes paid by its branch; this is the "direct" credit provided in Section 901 of the Code.

The purpose of the indirect credit of Section 902 is to extend the benefit of the foreign tax credit to domestic companies that operate through a foreign subsidiary (and therefore do not "directly" pay the foreign tax). As a Treasury spokesman stated in connection with the 1921 legislation that made the amount of the credit depend upon the subsidiary's "accumulated profits" (see pages 14-15, *supra*), an American corporation operating through a foreign subsidiary is "economically and practically" in the same position as one operating through a foreign branch and "[t]he proposal is to give this American corporation about the same credit as if conducting a branch" (*Hearings on H.R. 8245 Before the Senate Comm. on Finance*, 67th Cong., 1st Sess. 389 (1921) (statement of Dr. Adams)). See also *Associated Telephone & Telegraph Co.* v. *United States*, 306 F.2d 824, 832 (2d Cir. 1962), cert. denied, 371 U.S. 950 (1963). The provision involved in this case, which prorates the credit when the subsidiary does not return all of its earnings to the parent, was enacted to prevent the corporation operating through a subsidiary from receiving a *greater* tax benefit than one operating through a branch. See 61 Cong. Rec. 7184 (1921) (statement of Sen. Smoot). And subsequent amendments to the foreign tax provisions have been designed in part to improve attainment of this goal of putting the two similar modes of conducting foreign business on an equal footing for foreign tax credit purposes. See S. Rep. No. 313, 99th Cong., 2d Sess. 306 (1986) (change designed "to provide more similar results" for branch and subsidiary

operations); S. Rep. No. 1881, 87th Cong., 2d Sess. 66-67 (1962) ("gross-up" adjustment of I.R.C. § 78 necessary to eliminate tax advantage of subsidiary operation over branch operation); see generally B. Bittker & J. Eustice, *supra*, ¶ 17.11, at 17-45 to 17-47.

The decision of the court of appeals undermines this congressional policy by introducing major disparities in the treatment of companies depending upon whether they operate through a subsidiary or a branch. Foreign concepts of taxable income play no role in determining whether the earnings of a foreign branch constitute income in the hands of its domestic owner; those earnings flow directly to the owner and are recognized according to United States tax principles. To keep the two business arrangements on an equal footing, the accumulated profits of a foreign subsidiary must approximate the earnings that would be recognized by the parent if it were operating as a branch, *i.e.*, they must be computed under United States law. The correctness of this conclusion is illustrated by the basic example provided earlier (page 16, *supra*), where the foreign entity pays $20 in foreign tax on profits computed at $100 under United States law and $180 under foreign law. A foreign branch would be treated as having funneled all of its profits (which would be $100 computed under United States law) to the domestic company, and it would receive the full $20 "direct" credit under Section 901. If the same business were conducted by a foreign subsidiary, however, and the subsidiary distributed all of its after-tax profits to the parent, the court of appeals' approach would permit it take a credit for only part of the foreign taxes paid ($20 × $80/($180 − $20) = $10). Computing accumulated profits under United States law, conversely, would yield the correct result of a full $20 credit.

In this example, the foreign measure of income is higher than that under United States law, and therefore the result

under the court of appeals' approach is to understate the credit to the prejudice of the company operating through a subsidiary. If, as in the present case, the foreign definition of income yields a figure lower than that computed under United States law, the allowable credit will increase, thereby conferring a windfall benefit on the company that operates as a subsidiary. In both cases, however, the court of appeals' approach subverts the clearly expressed legislative policy to avoid discrimination between the two methods of doing business abroad.

In short, like the direct credit granted to a domestic company that operates through a foreign branch, the indirect credit of Section 902 treats the amount of foreign tax paid as a fact. It is not concerned with how the foreign tax is computed or with the foreign income base on which it is imposed. It simply takes the amount of foreign tax paid and apportions it in accordance with the fractional share of the subsidiary's United States income that is actually distributed as a dividend. To make the credit work properly, the term "accumulated profits" in Section 902 must refer to income computed under United States tax principles.

3. a. The decision below is of enormous importance to the public fisc and creates a serious problem for the fair administration of the tax laws. It is doubtful whether there is any foreign country whose income tax laws accord with those of the United States in every respect. Thus, the question presented here can arise no matter where a foreign subsidiary of a domestic corporation does business; it is likely to affect many large multinational corporations. While it is too early to quantify the potential impact of the decision below with any confidence, it is clearly very substantial. According to IRS statistics, in 1982 (the most recent year for which such figures are available), domestic

companies controlled more than 25,000 foreign subsidiaries doing business in more than 100 countries, and these companies claimed more than $9 billion in Section 902 credits for foreign taxes paid by those subsidiaries. A preliminary survey of IRS field offices indicates that, in cases currently under audit, there are about 30 refund claims based on the decision in this case that have been, or will be, filed—totalling about $150 million. In addition, the IRS estimates, as a result of communications with other taxpayers, that another 150 refund claims totalling $750 million will be filed in reliance on the decision below.

The massive revenue impact of the decision below is compounded by the fact that the court of appeals' decisions places the IRS in a whipsaw posture. The Federal Circuit is a court of nationwide jurisdiction. Any taxpayer, regardless of where it is domiciled or does business, is free to pay the contested tax and to sue for a refund in the Claims Court, with appellate review in the Federal Circuit. Thus, taxpayers can compute their Section 902 credit for a given tax year under both the traditional approach and the approach adopted by the court below and then elect the more favorable tax treatment by simple forum-shopping. If computation of accumulated profits under United States principles yields more favorable tax treatment, the taxpayer can rely upon the longstanding rule embodied in the Treasury regulations. On the other hand, if computing accumulated profits under foreign law principles yields a more favorable tax result, the taxpayer can realize a windfall like respondent's by litigating in the Claims Court. The Treasury would be caught in a no-win position, and evenhanded enforcement of the foreign tax credit provisions would be severely compromised. Moreover, the availability of such a tax-saving option to well-counseled companies that operate foreign subsidiaries

would further undermine the congressional goal of equality of treatment between companies that operate through foreign subsidiaries and those that operate through foreign branches (which always calculate their income from foreign operations under United States tax principles) (see pages 19-22, *supra).*

Finally, the court of appeals' decision also would impose new and formidable burdens on revenue agents and the courts. Under the heretofore settled rule, the foreign tax credit is computed solely by reference to the familiar principles of the Internal Revenue Code; the vagaries of foreign tax law play no role. The court of appeals' approach, however, would require that the court determine the taxpayer's accumulated profits under unfamiliar foreign principles of tax law, which may be difficult to ascertain and may contain concepts of profits and taxable income that are profoundly different from those of the United States. This imposition of a "shifting standard * * * adopted by reference to foreign characterizations and classifications of tax legislation" (*Biddle* v. *Commissioner,* 302 U.S. at 578-579) would create an unwelcome administrative and judicial burden. For all of these reasons, review by this Court is warranted to correct the court of appeals' erroneous and troublesome interpretation of the foreign tax credit provisions.

b. The prospective impact of the decision below has been diminished somewhat by Section 1202(a) of the Tax Reform Act of 1986, Pub. L. No. 514, 100 Stat., 2528. In that statute Congress prospectively changed the operation of the Section 902 credit to eliminate the "annualization" approach, *i.e.,* the manner in which the dividend is matched to accumulated profits on a year-by-year basis (see note 3, *supra*). Because Congress believed that this scheme was subject to manipulation by taxpayers and also subject to other problems, it provided that retained earn-

ings after 1986 would all go into one "pool," which would be the source of the dividends. See generally S. Rep. No. 313, *supra,* at 305-306; B. Bittker & J. Eustice, *supra,* ¶ 17.11, at 17-47 to 17-48. Congress accomplished this change by redrafting Section 902, including replacing the term "accumulated profits" with the term "post-1986 undistributed earnings." The latter term is defined as the "earnings and profits" of the foreign subsidiary accumulated in years after 1986 and computed "according to rules substantially similar to those applicable to domestic corporations" (see 26 U.S.C. 902(c)(1) (Supp. IV 1986) and 964(a)). Thus, while the 1986 legislation was not directed at the question presented in this case, its language will not support respondent's construction, and it would appear extremely unlikely that even the Federal Circiut would hold that foreign law principles must be used to determine the post-1986 earnings to be used in the prorated indirect credit computation.[8]

Despite the 1986 amendment, however, the issue presented in this case retains substantial continuing importance. Congress recognized that many foreign subsidiaries had retained pre-1987 profits, but it nevertheless decided that the 1986 amendment would operate only prospectively on post-1986 earnings; it specifically provided that prior law would continue to govern the distribution of pre-1987 earnings.[9] In other words, Congress deliberately per-

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[8] As we have noted (pages 11-12, *supra*), Congress clearly believed that it was perpetuating existing law in defining the subsidiary's profits to be used in the proration formula in terms of United States tax principles.

[9] Section 902(c)(6)(A) (Supp. IV 1986) of the new statute provides:

> In the case of any dividend paid by a foreign corporation out of accumulated profits (as defined in this section as in effect on the day before the date of the enactment of the Tax Reform Act of

petuated the pre-1986 statute, to the extent that a dividend distributed in later years comes out of pre-1987 earnings. It is not uncommon to have to go back a number of years to trace a dividend to the accumulated profits or earnings out of which it is paid. See, *e.g.*, *H. H. Robertson* v. *Commissioner*, 59 T.C. at 81 (dividend issued in 1965 attributed to accumulated profits of 1952-1964). Indeed, in this case the court of appeals' approach allows respondent to treat part of its 1971 dividend as having been paid out of its 1968 accumulated profits (see note 4, *supra*). Moreover, because dividends are attributed to accumulated profits on a last-in, first-out basis (see 26 U.S.C. 902(c)(6)(B) (Supp. IV 1986)), a corporation's dividend could still be derived, many years into the future, from pre-1987 accumulated profits, thus triggering the issue in this case. Therefore, although its prospective impact for post-1986 tax years has been diminished by the 1986 legislation, the decision below will continue to have deleterious consequences for the administration of the foreign tax credit for tax years well beyond 1986. And, of course, the 1986 legislation has no effect at all on the numerous and substantial refund claims that are likely to be filed for open tax years prior to 1987. Accordingly, the decision below is of considerable continuing importance, and review by this Court is warranted to correct the court of appeals' error and restore even-handed administration of this important aspect of the tax laws.

1986) for taxable years beginning before the 1st taxable year taken into account in determining the post-1986 undistributed earnings of such corporation—

(i) this section (as amended by the Tax Reform Act of 1986) shall not apply, but

(ii) this section (as in effect on the day before the date of the enactment of such Act) shall apply.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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MARCH 1989

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

No. 88-1201

THE GOODYEAR TIRE & RUBBER COMPANY AND AFFILIATES, PLAINTIFF-APPELLANT

v.

THE UNITED STATES, DEFENDANT-APPELLEE

Decided: Aug. 31, 1988

[Filed Aug. 31, 1988]

Before NEWMAN and BISSELL, Circuit Judges and RE, Chief Judge.*

BISSELL, Circuit Judge.

The Goodyear Tire & Rubber Company and Affiliates (collectively, Goodyear) appeal the decision of the United States Claims Court, *Goodyear Tire & Rubber Co. v. United States,* 14 Cl. Ct. 23 (1987), granting summary judgment to the United States and holding that Goodyear was not entitled to a tax refund. Judgment was entered dismissing the complaint. We reverse.

BACKGROUND

Goodyear Tire & Rubber Company (Goodyear U.S.) is the parent of the consolidated group of United States cor-

* The Honorable Edward D. Re, Chief Judge, United States Court of International Trade, sitting by designation pursuant to 28 U.S.C. § 293(a) (Supp. IV 1986).

porations constituting the appellant. The Goodyear Tyre & Rubber Company (Great Britain) Limited (Goodyear U.K.) is a British corporation and a wholly owned subsidiary of Goodyear U.S.

During 1970 and 1971, Goodyear U.K. derived profits from business activities it conducted in Great Britain and, to a lesser extent, the Republic of Ireland. In each of these years, Goodyear U.K. first paid income taxes on profits to the governments of Great Britain and Ireland, and then distributed dividends to Goodyear U.S. When Goodyear U.S. reported these dividends for American tax purposes, it claimed foreign tax credits as allowed under section 902 of the Internal Revenue Code of 1954.

In 1972 and 1973, Goodyear U.K. incurred net operating losses. The 1973 loss is particularly illustrative of the issue presented because that loss included British tax deductions[1] that were not allowable under American tax laws. For British tax purposes, the 1971 and 1970 records of Goodyear U.K. were adjusted to "carry back" the 1973 loss.[2] These loss carry-back adjustments resulted in the British government refunding to Goodyear U.K. the tax payments it had made for 1971 and 1970.

In light of those refunds, the Commissioner of the Internal Revenue Service (IRS) redetermined, for foreign tax credit purposes, the 1971 and 1970 records of Goodyear U.S. The IRS based its redetermination on American tax law. Because American law did not recognize the 1973

[1] One deduction permitted accelerated depreciation write-offs, and the other permitted a special inventory reduction.

[2] A 1972 loss eliminated the 1972 accumulated profits and a portion of the 1971 accumulated profits. Therefore, the 1973 loss was applied back to 1971 and 1970 accumulated profits. The 1973 loss carry-back eliminated all accumulated profits for 1971, and substantially reduced the accumulated profits of 1970.

deductions permitted under British law, the IRS's redetermination converted the 1973 Goodyear U.K. loss to a profit, obviating the need to carry back any losses to 1971 and 1970. Therefore, under American tax law, Goodyear U.K. recorded profits for 1971 and 1970, yet because of the tax refunds, there was effectively no longer any foreign tax assessed on those profits. The IRS accordingly determined that Goodyear U.S. was not entitled to the foreign tax credits previously taken because there was no double taxation. Consequently, the IRS assessed $791,240.72[3] against Goodyear U.S. to recover the resultant tax deficiency.

Goodyear U.S. paid the deficiency and then filed timely refund claims. The IRS denied the refund claims in 1983. Thereafter, Goodyear U.S. filed suit in the United States Claims Court seeking a refund. Goodyear U.S. asserted that the IRS had erred by incorrectly applying American instead of British tax law in its redetermination of accumulated profits.

The Claims Court (1) held that accumulated profits under section 902 must be calculated in accordance with American tax law, and (2) found Goodyear U.S. was not entitled to a tax refund. Goodyear U.S. appeals the Claims Court decision.

ISSUE

Whether 26 U.S.C. § 902(a) requires accumulated profits to be computed under American or foreign tax law.

[3] The recomputation resulted in tax assessments of $323,654 (1970) and $237,616 (1971) plus interest penalties of $132,611.66 (1970) and $97,359.06 (1971) to total $791,240.72.

OPINION

Under section 902(a), foreign tax credits are computed in the following manner:

> [A] domestic corporation which owns at least 10 percent of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall be deemed to have paid the same proportion of any income, war profits, or excess profits taxes paid or deemed to be paid by such foreign corporation to any foreign country or to any possession of the United States, on or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends (determined without regard to section 78) bears to the amount of such accumulated profits in excess of such income, war profits, and excess profits taxes (other than those deemed paid).

26 U.S.C. § 902(a) (1982). This statute establishes a relationship between the foreign taxes paid (T), the dividends received by the domestic corporation (D), and the accumulated profits (P) from which the dividends were derived. This relationship is represented by the following mathematical expression:

Section 902 Formula

$$\begin{array}{c}\text{(C)}\\ \text{Section}\\ \text{902}\\ \text{Credit}\end{array} = \begin{array}{c}\text{(T)}\\ \text{Foreign Income}\\ \text{Tax Paid By}\\ \text{Foreign Subsidiary}\end{array} \times \frac{\text{(D) Dividend Received by Domestic Parent}}{\text{(P) Accumulated Profits of the Foreign Subsidiary Minus Foreign Tax Paid}}$$

See, e.g., *Champion Int'l Corp. v. Commissioner*, 81 T.C. 424, 429 (1983); *H. H. Robertson Co. v. Commissioner*, 59 T.C. 53, 77 (1972), *aff'd*, 500 F.2d 1399 (3d Cir. 1974).

Section 902(c)(1) recognizes the power of foreign countries to tax "gains, profits, and income" derived within their territories. "T" in the above equation, therefore, is the amount of tax actually imposed on a foreign subsidiary by a foreign government under foreign tax law. *See Biddle v. Commissioner*, 302 U.S. 573, 578 (1938) (stating that foreign law governs when express language or necessary implication of American statute requires). The parties do not dispute this.

The parties do, however, contest whether American or British law controls the definition of "accumulated profits"—"P" in the equation. The government maintains that American law must govern the definition of "P", while Goodyear asserts that British law controls. In resolving this issue, the court notes that the term "accumulated profits" is used in the Internal Revenue Code only with reference to foreign tax credit. For the reasons discussed below, we agree with Goodyear.

Section 902(a) states that a parent corporation may obtain a tax credit on "*taxes paid* . . . by such foreign [subsidiary] corporation *to any foreign country* . . . *on or with respect to the accumulated profits of such foreign corporation* . . . ." (Emphasis added.) The definition of "accumulated profits" provided in section 902(c) similarly relates the foreign taxes paid to accumulated profits:

> For purposes of this section [Foreign Tax Credit], the term *"accumulated profits" means*, with respect to any foreign corporation, *the amount of* its *gains, profits, or income computed without reduction by* the amount of the income, war profits, and excess profits *taxes imposed on or with respect to such profits or income* by any foreign country or by any possession of the United States. (Emphasis added.)

26 U.S.C. § 902(c)(1) (1982).

These provisions establish that "P" is the actual basis on which the foreign sovereign assesses tax liability. Because "T" is the actual tax imposed by the foreign government, "P" must also be the basis to which the foreign government applies its own tax law in computing "T". Rev. Rul. 74-310, 1974-2 C.B. 205 (foreign income tax to be used in section 902 computation is amount of tax imposed on total profits as measured by foreign standards). For this reason, we find the plain meaning of the statute requires "P" to be determined under foreign law.

Congress' rationale for enacting section 902 supports our interpretation. "[T]he fundamental purpose of the foreign tax credit is the elimination of international double taxation." *Robertson*, 59 T.C. at 74; *see also American Chicle Co. v. United States*, 316 U.S. 450, 452 (1942); *National Cash Register Co. v. United States*, 400 F.2d 820, 825-26 (6th Cir. 1968), *cert. denied*, 394 U.S. 917 (1969); *Steel Improvement & Forge Co. v. Commissioner*, 36 T.C. 265, 282 (1961), *rev'd on other grounds*, 314 F.2d 96 (6th Cir. 1963). The IRS position that accumulated profits must be determined under American tax law, however, can defeat this purpose by severing the relationship between "T" and "P".

In the instant case, because American tax law did not recognize the 1973 loss, the IRS-computed accumulated profits of Goodyer U.K. for 1970 and 1971 were higher than the amounts recognized under British law. Adopting the IRS view inflates "P", the denominator in the section 902(a) formula. When the numerator "D" is constant, an increase in the denominator will reduce the maximum amount of tax credit available. Such a reduction prohibits the taxpayer from being able to obtain a tax credit for the full amount of the foreign taxes paid. Therefore, the tax payments already made to the foreign country will not be

fully recoverable as tax credits to reduce the subsequent tax assessments by the United States government. This effectively results in a double taxation that contravenes the purpose of the statute.

In support of its position, the IRS suggests a long history of precedents for using American law to determine accumulated profits. However, the cases presented in support of the IRS's position fail to address the controversy raised in the instant case. Rather, the cases cited recognize the undisputed and well-settled fact that "the determination of a foreign corporation's *earnings and profits* [not accumulated profits], for purposes of the imposition of the U.S. tax, is to be made by the application of U.S. tax principles." *Robertson*, 59 T.C. at 69 (emphasis added); *Steel Improvement*, 36 T.C. at 277, *rev'd on other grounds*, 314 F.2d 96 (1963); *see also Untermyer v. Commissioner*, 24 B.T.A. 906, 912 (1931), *aff'd*, 59 F.2d 1004 (2d Cir.), *cert. denied*, 287 U.S. 647 (1932). These cases only support the distinction between computing *accumulated profits* for foreign tax credit purposes, and computing *earnings and profits* for dividend characterization purposes.

The one unpublished case, not cited by the IRS, but which supports its outcome, *Pacific Gamble Robinson Co. v. United States*, No. 5155, 62-1 U.S. Tax Cas. (CCH) § 9,160 (W.D. Wash. Dec. 15, 1961) (plaintiff was not entitled to foreign tax credit when foreign tax for period in which dividend arose was refunded), was specifically rejected by the Tax Court in *Champion*, 81 T.C. at 443 n.29.

The IRS nevertheless relies on *Champion* for the holding that "*[a]ccumulated profits* are determined under American law rather than foreign law." *Champion*, 81 T.C. at 447 (citing *Steel Improvement*, 36 T.C. at 277) (emphasis added). However, such reliance is misplaced. The *Champion* dictum misstated the actual text of *Steel*

Improvement which stated that "accumulated *earnings and profits* . . . are to be determined under American rather than foreign law." *Steel Improvement*, 36 T.C. at 277 (emphasis added). The determination of "accumulated earnings and profits" for United States income tax purposes is distinguishable from the determination of "accumulated profits" for deemed foreign tax credit purposes. Absent this point of confusion, *Steel Improvement* and *Champion* are consistent with the court's position.

CONCLUSION

In light of the foregoing, we reverse, as a matter of law, the judgment of the Claims Court and find that "accumulated profits," for purposes of determining deemed paid foreign tax credits, are to be based upon foreign law.

REVERSED

APPENDIX B

IN THE UNITED STATES CLAIMS COURT

No. 510-85T

THE GOODYEAR TIRE & RUBBER COMPANY AND AFFILIATES, PLAINTIFF

v.

THE UNITED STATES, DEFENDANT

(Filed: Dec. 8, 1987)

ORDER

TIDWELL, Judge:

This tax refund case came before the court for disposition on plaintiff's motion for summary judgment to determine whether foreign tax law concepts are controlling when computing indirect tax credits under section 902 of the Internal Revenue Code of 1954, 26 U.S.C. § 902 (1954), and in the alternative, whether the payments received by its foreign subsidiary from the British government during 1975 and 1976 were properly classified and treated as refunds for years 1970 and 1971 under section 905 of the Internal Revenue Code of 1954, 26 U.S.C. § 905 (1954). Defendant brought a cross-motion for summary judgment claiming that United States tax law con-

cepts are controlling for purposes of section 902 and that the Commissioner of Internal Revenue acted properly under section 905 when he directed that the section 902 indirect tax credits claimed by plaintiff on its 1970 and 1971 United States income tax returns be recomputed upon receipt of tax refunds in 1975 and 1976 by the foreign subsidiary for the years 1970 and 1971.

FACTS

In 1970 and 1971, Goodyear Tire & Rubber Company, Ltd. (Goodyear England), a Great Britain corporation and plaintiff's wholly owned subsidiary, operated at a profit and paid dividends to plaintiff.[1] During this time, Goodyear England was engaged in business in Great Britain and, to a small extent, in the Republic of Ireland. It conducted no business in the United States and, consequently, had no income subject directly to United States income taxes. Plaintiff, therefore, claimed foreign tax credits in 1970 and 1971 pursuant to section 902(a)(1) for British taxes deemed paid on the dividends by Goodyear England.[2]

In 1972, Goodyear England operated at a loss. This loss, recognized under both United States and British tax law, was carried back to 1971 and applied to reduce Goodyear England's 1971 accumulated profits. Because the

[1] The Goodyear Tire & Rubber Company is the parent of the consolidated group of United States corporations constituting the plaintiff.

[2] A condition for the credit is that the domestic corporation satisfy certain ownership requirements in the foreign corporation. The only such ownership requirement applicable here is that the United States parent corporation own at least ten percent of the voting stock of the foreign corporation. 26 U.S.C. § 902(a)(1) (1954). There is no dispute that plaintiff satisfies this requirement since Goodyear England is plaintiff's wholly owned subsidiary.

amount of the 1972 loss was known prior to the time Goodyear England paid its 1971 taxes, the dividend paid to plaintiff in 1971 was considered to have been paid out of Goodyear England's accumulated profits as reduced by both its 1972 loss and the 1971 taxes paid thereon.

In 1973, Goodyear England incurred another net operating loss. This loss, however, was attributable to two British tax deductions not allowable under United States tax law. The first permitted accelerated depreciation write-offs and the second permitted inventory reductions by the increase in inventory value less ten percent of trading profit for the year. Since 1972 was also a loss year, Goodyear England carried back its 1973 net operating loss in accordance with British tax law to both 1971, where it more than eliminated all accumulated profits, and 1970, where it substantially reduced accumulated profits. The British government subsequently made refund payments to Goodyear England during 1975 and 1976 amounting to £650,000 for the adjustment to its 1971 accumulated profits and £671,599 for the adjustment to its 1970 accumulated profits.

In 1980, as a consequence of the payments to Goodyear England by the British Government in 1975 and 1976, the Commissioner of Internal Revenue, asserting authority under section 905, recomputed the section 902(a)(1) tax credits claimed by plaintiff on its 1970 and 1971 United States income tax returns. The Commissioner converted Goodyear England's 1973 loss under British tax law to a profit of £1,137,152 in accordance with United States tax law which did not allow the accelerated depreciation or special inventory deductions permitted by Great Britain. On November 21, 1980, the Commissioner adjusted the foreign tax credits claimed by plaintiff in 1970 and 1971 and timely assessed the following deficiencies, plus interest

thereon, owed by plaintiff as a result of these new computations:

YEAR	TAX	INTEREST	TOTAL
1970	$323,654	$132,611.66	$456,265.66
1971	237,616	97,359.06	334,975.06
			791,240.72

Plaintiff subsequently paid the tax deficiencies to the Internal Revenue Service Center, Cincinnati, Ohio on December 3, 1980.

In November 1982, plaintiff filed timely refund claims with the IRS for the assessed deficiencies plus interest thereon. The Regional Commissioner of Internal Revenue issued a notice of disallowance of the refund claims on September 30, 1983. Plaintiff subsequently filed its Complaint in this court to recover $791,240.72 paid to IRS, plus interest thereon, as a result of the adjustments to its 1970 and 1971 United States income tax returns.

DISCUSSION

Summary judgment is appropriate when there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. RUSCC 56(c). In evaluating a motion for summary judgment, any doubt must be resolved in favor of the nonmoving party. *Housing Corp. v. United States,* 199 Ct. Cl. 705, 710, 468 F.2d 922, 924 (1972); *Campbell v. United States,* 2 Cl. Ct. 247, 249 (1983). In addition, the "inferences to be drawn from the . . . facts . . . must be viewed in the light most favorable to the party opposing the motion" for summary judgment. *Adickes v. S.H. Kress & Co.,* 398 U.S. 144, 158-59 (1970) (quoting *United States v. Diebold, Inc.,* 369 U.S. 654, 655 (1962)); *Ball v. United States,* 1 Cl. Ct. 180, 183

(1982). The court agrees with the parties that there are no genuine issues of material fact in dispute and that this case is properly before the court for disposition on cross-motions for summary judgment.

I. Application of Sections 901 and 902

Section 901(a) of the Internal Revenue Code of 1954, 26 U.S.C. § 901(a) (1954)[3], in accordance with section 901(b)(1) of the Internal Revenue Code of 1954, 26 U.S.C. § 901(b)(1) (1954)[4], permits domestic taxpayers to elect to receive a credit, within prescribed limits, for any foreign income tax paid, or deemed to have been paid, during the taxable year. Section 902(a)(1) prescribes the terms under which the deemed paid foreign tax credit is allowed and explains the manner in which this credit is to be computed. The statute provides in pertinent part:

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[3] The relevant part of the statute as in effect for the period here in controversy is as follows:

> (a) Allowance of Credit – If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall . . . be credited with the amounts provided in the applicable paragraphs of subsection (b) plus, in the case of a corporation, the taxes deemed to have been paid under sections 902 and 960. . . .

26 U.S.C. § 901(a) (1954).

[4] The relevant part of the statute as in effect for the period here in controversy is as follows:

> (b) Amount Allowed – Subject to the applicable limitation of section 904, the following amounts shall be allowed as the credit under subsection (a):
>
> > (1) Citizens and domestic corporations – In the case of a . . . domestic corporation, the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country. . . .

26 U.S.C. § 901(b)(1) (1954).

[a] domestic corporation which owns at least 10 percent of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall—

> (1) to the extent such dividends are paid by such foreign corporation out of accumulated profits (as defined in subsection (c)(1)(A)) of a year for which such foreign corporation is not a less developed country corporation, be deemed to have paid the same proportion of any income, war profits, or excess profits taxes paid or deemed to be paid by such foreign corporation to any foreign country . . . on or with respect to such accumulated profits . . . which the amount of such dividends (determined without regard to Section 78) bears to the amount of such accumulated profits in excess of such income, war profits, and excess profits taxes (other than those deemed paid). . . .

26 U.S.C. § 902(a)(1) (1954).

Section 902(a)(1) requires the deemed paid foreign tax credit claimed by a domestic corporation with regard to dividends received from a foreign subsidiary to be computed by multiplying the amount of foreign income tax the foreign subsidiary paid "on or with respect to" that years accumulated profits by a fraction. *Champion Int'l Corp. v. Commissioner of Internal Revenue,* 81 T.C. 424, 429 (1983); *H.H. Robertson Co. v. Commissioner of Internal Revenue,* 59 T.C. 53, 77 (1972), *aff'd,* per order, (3rd Cir. 1974). The numerator of the fraction is the dividend paid to the domestic corporation by the foreign subsidiary out of the foreign subsidiary's accumulated profits for the tax year. *Id.* The denominator of the fraction is the accumulated profits for the tax year minus the foreign tax paid by

the foreign subsidiary. *Id.*[5] Both parties in this case agree that the equation set forth by the court is the proper mathematical expression of section 902(a)(1).[6] The parties disagree, however, as to whether the denominator of this fraction, *i.e.,* accumulated profits of the foreign subsidiary minus the foreign income tax paid by the foreign subsidiary, must be computed under British or United States tax law.

Plaintiff contended that in computing its section 902(a)(1) tax credit for dividends received from Goodyear England during 1970 and 1971, the accumulated profits of Goodyear England must be computed in accordance with British tax law concepts so that each year's accumulated

[5] Section 78 of the Internal Revenue Code of 1954, 26 U.S.C. § 78 (1954), requires that the amount of tax deemed paid by the domestic corporation be included in its gross income, a computation referred to as "grossing-up." When there is grossing-up, the denominator of the section 902 tax credit equation is equal to accumulated profits of foreign subsidiary without reduction for the amount of foreign tax paid by the foreign subsidiary on such profits. When there is no grossing-up, the denominator is equal to accumulated profits of foreign subsidiary minus the amount of foreign tax paid by the foreign subsidiary on such profits. Section 78 is not applicable, and therefore no grossing-up is required, when "any amount of United Kingdom income tax appropriate to a dividend paid by a corporation which is a resident of the United Kingdom . . . is included in the gross income of such domestic corporation in accordance with Article XIII of the income tax convention between the United States and the United Kingdom." Treas. Reg. § 1.78-1(c) (1965). The parties concur as to the appropriateness of the section 902 equation.

[6] Section 902(a)(1) may be expressed as the following mathematical equation:

$$\begin{array}{c}\text{Section 902}\\ \text{Credit}\end{array} = \begin{array}{c}\text{Foreign Income}\\ \text{Tax Paid by}\\ \text{Foreign Subsidiary}\end{array} \times \frac{\begin{array}{c}\text{Dividends Received by}\\ \text{Domestic Parent}\end{array}}{\begin{array}{c}\text{Accumulated Profits}\\ \text{of Foreign Subsidiary minus}\\ \text{Foreign Tax Paid}\end{array}}$$

profit is matched properly with the foreign tax imposed on those profits. Plaintiff argued that if British tax concepts are not followed, the British taxes imposed on Goodyear England will be matched with accumulated profits of a different year and result in double taxation. The defendant claimed, however, that United States tax law should be applied for foreign tax credit purposes because there is nothing set forth in either section 902(a)(1) or section 902(c)(1)(A) to indicate that the statutory term "accumulated profit" should be equated with foreign taxable income. Defendant claimed that "accumulated profit" refers instead to United States taxable income and requires a computation which is exactly the same as if the foreign subsidiary were itself a domestic corporation. Both parties cite *Champion International Corp. v. Commissioner,* 81 T.C. 424 (1983) and *Steel Improvement and Forge Co. v. Commissioner,* 36 T.C. 265 (1961), *rev'd on other grounds,* 314 F.2d 96 (6th Cir. 1963), for support. The court, recognizing the Tax Court's expertise in addressing the substantive questions of law presented by this case, will review the parties' contentions in light of these two Tax Court decisions prior to discussing the statutory language itself and its applicable legislative history and administrative interpretation.

In *Champion International,* a domestic corporation received a dividend from its Canadian subsidiary in 1971 and claimed a foreign tax credit pursuant to section 902. The subsidiary had operated at a profit in 1969 and 1971, but incurred a loss in 1970. The loss, recognized by both United States and Canadian tax law, was carried back to 1969 in accordance with Canadian carryback provisions resulting in a partial refund of Canadian taxes previously paid by the subsidiary for 1969. The Tax Court held that when computing the foreign tax credit for the 1971 dividend the foreign subsidiary's 1969 accumulated profits

were to be reduced by the amount of the loss carryback from 1970 for purposes of the denominator as well as the numerator of the fraction in the statutory formula.

Plaintiff in the case at bar contended that *Champion International* stands for the proposition that foreign tax law is controlling when computing the accumulated profits of a subsidiary and the subsequent amount of taxes deemed paid. Plaintiff's reliance is misplaced. Although the 1970 loss was carried back in accordance with foreign tax law, the threshold questions as to whether there was a loss, and the subsequent determination of the amount of the loss, were decided pursuant to United States tax law. *Champion International,* 81 T.C. at 433. Thus, the accumulated profits computed under United States tax law and the taxes paid by the subsidiary computed under Canadian tax law were both reduced as a result of the loss because both United States and Canadian tax law recognized the loss. *Id.* at 447.

In *Steel Improvement*[7] the taxpayer was a domestic corporation which in 1954 received a dividend from its wholly owned Canadian subsidiary. The subsidiary reported a taxable loss for 1954 in its Canadian tax return and carried the loss back to 1953 offsetting taxable income previously reported for that year and causing the taxes previously paid to be refunded. The loss, however, was caused by a special Canadian tax provision that would not have been an allowable deduction under United States tax law. In fact, applying United States tax law, the subsidiary actually sustained a profit for 1954.

[7] *Steel Improvement,* although reversed on other grounds, rendered the Tax Court's holding on the foreign tax credit issue meaningless so far as the rights of the parties to that case were concerned. It nevertheless represents sound analysis and is further illustrative of the complex relationship that exists between foreign losses and section 902 deemed paid foreign tax credits.

The Tax Court held in *Steel Improvement* that the taxpayer's deemed paid foreign tax credit must be adjusted to account for the refund of Canadian taxes to its subsidiary, in spite of the fact that the 1954 loss was not to be recognized for purposes of reducing the subsidiary's accumulated profits in the section 902 equation. *Steel Improvement,* 36 T.C. at 282. The court did not recognize the reduction in accumulated profits because the loss resulted from a special Canadian accelerated depreciation allowance that was not an allowable deduction under United States tax law. *Id.* at 277. As the court explained in *Champion International*:

> In *Steel Improvement & Forge Co.,* the carryback of the loss did not affect the accumulated profits of the carryback year or the determination of what year's accumulated profits were the source of the dividend therein concerned. This is because the loss was caused by a deduction not recognized by U.S. law. Therefore, although the loss eliminated the Canadian *tax* of both the loss year and the carryback year, it left the *accumulated profits* of those years unaffected. Accumulated profits are determined under American law rather than foreign law.

Champion International, 81 T.C. at 447 (emphasis in original).

In the case at bar, the 1972 loss sustained by Goodyear England was recognized by both United States and British tax law and, as a result, operated to reduce both Goodyear England's accumulated profits and its tax liability for 1972 and 1971, the carryback years, as in *Champion International.* The 1973 loss, however, was not recognized under United States tax law. Thus, although the loss reduced Goodyear England's tax liability under British tax law for 1973, 1971 and 1970, the carryback years, it should leave

the accumulated profits of those years intact for purposes of the Section 902 indirect tax credit computation, as in *Steel Improvement.* The court, therefore, concludes that defendant correctly adjusted Goodyear England's 1973 profits to correspond with United States tax law. The court does not hold, however, that accumulated profit is in all cases equivalent to United States earnings and profits and should be computed exactly as if the foreign subsidiary were itself a domestic corporation. Such a conclusion must be arrived at independently on a case by case basis given the complexities inherent in the applicable code provisions and in order to reach the underlying purposes Congress had in mind when enacting the indirect tax credit legislation.

A. The Statutory Framework

It is axiomatic that in determining the meaning of a statute, the inquiry must first be directed to the statutory language itself and, if the language is unambiguous, the duty of interpretation does not arise. *American Tobacco Co. v. Patterson,* 456 U.S. 63, 68 (1982); *Flora v. United States,* 357 U.S. 63, 65 (1958); *Caminetti v. United States,* 242 U.S. 470, 485 (1917); *Lykes Bros. S.S. Co., Inc. v. United States,* 206 Ct. Cl. 354, 356, 513 F.2d 1342, 1349 (1975); *United Am. Ins. Co. v. United States,* 201 Ct. Cl. 32, 33, 475 F.2d 612, 614 (1973); *Freese v. United States,* 6 Cl. Ct. 1, 17 (1984), *aff'd mem.,* 770 F.2d 177 (Fed. Cir. 1985); *J. H. Miles & Co., v. United States,* 3 Cl. Ct. 10, 13 (1983). In such circumstances, the court is limited to enforcing the statute according to its expressed terms.

Section 902(c)(1)(A) defines "accumulated profits" for purposes of the indirect foreign tax credit as follows:

> (1) Accumulated profits defined.—For purposes of this section, the term 'accumulated profits' means

> with respect to any foreign corporation—(A) for purposes of subsections (a)(1), (b)(1)(A), and (b)(2)(A), the amount of its gains, profits or income computed without reduction by the amount of the income, war profits, and excess profits taxes imposed on cr with respect to such profits or income by any foreign country. . . .
>
> * * * * *
>
> The secretary or his delegate shall have full power to determine from the accumulated profits of what year or years such dividends were paid, treating dividends paid in the first 60 days of any year as having been paid from the accumulated profits of the preceding year or years . . . and in other respects treating dividends as having been paid from the most recently accumulated gains, profits or earnings.

26 U.S.C. § 902(c)(1)(A) (1954). In addition, section 902(a)(1) provides that, to the extent a qualifying domestic corporation receives dividends which are paid by a foreign corporation out of accumulated profits, the domestic corporation shall be deemed to have paid the same proportion of foreign taxes paid "on or with respect to such accumulated profits, which the amount of such dividends . . . bears to the amount of such accumulated profits in excess of such income, war profits and excess profits taxes. . . ." 26 U.S.C. § 902(a)(1) (1954).

The repeated reference to "such accumulated profits" demands that the meaning assigned to the term be consistent throughout the section 902 indirect tax credit formula. *Champion Int'l Corp. v. Commissioner of Internal Revenue,* 81 T.C. 424, 435 (1983). Both parties in the present case agree that United States tax law governs the definition of the numerator, that is, whether a distribution of property by a foreign subsidiary to a domestic parent

corporation is a dividend or a return of capital. *Untermyer v. Commissioner of Internal Revenue,* 24 B.T.A. 906 (1931), *aff'd,* 59 F.2d 1004 (2d Cir.), *cert. denied,* 287 U.S. 647 (1932). United States tax law also governs what foreign taxes qualify as income taxes for indirect tax credit purposes. *Keasbey & Mattison Co. v. Rothensies,* 133 F.2d 894 (3rd Cir.), *cert. denied,* 320 U.S. 739 (1943). Accumulated profits in the denominator of the indirect tax credit equation represent the fund from which dividends in the numerator of the equation are paid. Algebraic consistency requires that United States tax law similarly govern the computation of the foreign subsidiary's accumulated profits, *i.e.,* the fund from which the dividends are paid and the amount upon which the tax is based. According to two commentators who have written extensively on the indirect credit:

> After all the profits of a year have been distributed, the quantity used in the numerator of the fraction, dividends, must be the same as the amount used in the denominator, net profits. Otherwise, the amount of indirect credit will be either more or less than the amount of the foreign tax actually paid. In short, the section 902 allocation fraction functions properly only when the definition of dividends (aggregate) and net profits is exactly the same.

1 E. Owens & G. Ball, *The Indirect Credit* 162 (1975). The statute itself is silent, however, as to whether accumulated profits are to be computed in accordance with United States or foreign tax law. Thus, in this area of law fraught with complex definitional concepts, the court cannot look only to the express language of the statute. *Champion Internat'l,* 81 T.C. at 436. *See also, Associated Telephone & Telegraph Co. v. United States,* 306 F.2d 824, 832 (2d Cir. 1962) (a court must consider the policies behind the foreign tax credit generally rather than terminology itself).

Lack of clarity in statutory language requires a court to instead "find that interpretation which can most fairly be said to be embedded in the statute, in the sense of being most harmonious with its cheme and with the general purposes that Congress manifested." *NLRB v. Lion Oil Co.*, 352 U.S. 282, 297 (1957); *see also Bailey v. United States,* 206 Ct. Cl. 169, 178, 511 F.2d 540, 546 (1975); *Aking v. United States,* 194 Ct. Cl. 477, 483, 439 F.2d 175, 177 (1971); *Conlon v. United States,* 8 Cl. Ct. 30, 33 (1985); *Witco Chemical Corp. v. United States,* 2 Cl. Ct. 504, 507 (1983), *aff'd,* 742 F.2d 615 (Fed. Cir. 1984). When statutory language is nebulous, literal interpretation will be eschewed in favor of a more flexible inquiry into legislative intent, *Texas State Comm'n for the Blind v. United States,* 6 Cl. Ct. 730, 738 (1984), and into regulations promulgated by the administrative agency entrusted with the obligation of enforcing the statute. *Sohio Transp. Co. v. United States,* 5 Cl. Ct. 620, 629 (1984), *aff'd,* 766 F.2d 499 (Fed. Cir. 1985).

B. The Legislative History

In enacting section 238(e) of the Internal Revenue Act of 1921, the predecessor of section 902, Congress stated:

> In such a case a foreign subsidiary is much like a foreign branch of an American corporation. If the American corporation owned a foreign branch, it would include the earnings or profits of such branch in its total income, but it would also be entitled to deduct from the tax based upon such income any income or profits taxes paid to foreign countries by the branch in question. Without special legislation however, no credit can be obtained where the branch is incorporated under foreign laws.

> Since the foreign subsidiary may not send back to the American parent company all of its profits or earnings, it follows that the American parent company should not obtain a credit for all the income and profits taxes paid to foreign countries. The amendment in question grants only a partial or prorated credit.

61 Cong. Rec. 7184 (1921). Where congress adopts a new law incorporating a prior law, Congress can be presumed to acquiesce in the purpose of the incorporated law. *Seaboard Air Line R. Co. v. United States,* 113 Ct. Cl. 437, 447, 83 F.Supp. 1012, 1015, *cert. denied,* 338 U.S. 848 (1949); *Massachusetts Mut. Life Ins. Co. v. United States,* 5 Cl. Ct. 581 (1984), *aff'd,* 761 F.2d 666 (Fed. Cir. 1985). There are three principal purposes of the indirect tax credit provisions, *i.e.,* to treat foreign subsidiaries and foreign branches of domestic corporations similarly, to eliminate double taxation and to limit the amount of foreign credit a domestic corporation is permitted to claim with respect to foreign taxes paid by its foreign subsidiary. The court's holding that United States tax law concepts must be applied to adjust the foreign subsidiary's profits for purposes of section 902 effectuates congressional intent.

Defendant did not recognize Goodyear England's 1973 loss carryback of £3,375,375 and instead converted the loss to a profit of £1,137,152 since United States tax law did not allow the two British deductions which precipitated the loss. Defendant then adjusted Goodyear England's accumulated profits for 1970 and 1971 to £3,812,467 and £3,224,486 respectively and recomputed plaintiff's tax credit to equal £235,038 in 1970 and £12,086 in 1971. The Commissioner further determined that since United States tax law did not recognize Goodyear England's claimed 1973 British tax loss, the denominator of the section 902 tax credit equation still exceeded the

stipulated dividends in the numerator. Thus, contrary to plaintiff's computations and sourcing arguments, there was no need to proportion the dividends received by plaintiff in 1970 and 1971 to accumulated profits of other previous years.

Contrary to plaintiff's contention, the above computations do not result in double taxation. It is true that the foreign subsidiary, pursuant to British tax law, claimed a loss in 1973 which it was permitted to carry back to reduce its profits for 1970 and 1971. When determining a section 902 credit for a domestic parent, however, the foreign subsidiary's profits must be adjusted in accordance with United States tax law. *Champion International*, 81 T.C. at 447. The parties have stipulated that all adjustments made by the Commissioner were proper under United States tax law and that the two British deductions which resulted in the 1973 loss were not allowable deductions under United States tax law. The adjustments were, therefore, proper and double taxation is avoided because the profits from which the dividends were paid in 1970 and 1971 were not reduced by the amount of the loss and, in addition, the subsidiary incurred no tax liability on these profits as a result of the tax refunds. However, the refund of 1970 and 1971 taxes to the subsidiary must still be accounted for when computing the section 902 credit to ensure that credit given to the domestic parent accurately reflects taxes actually paid by its foreign subsidiary. *Id.* In the case at bar, the subsidiary paid no taxes for 1970 and 1971 as a result of the refunds it received during 1975 and 1976. To not recognize this fact as plaintiff urges would eviscerate the very purpose of the pro-rata credit and permit plaintiff a substantial windfall in avoiding other taxes with the phantom taxes deemed paid.

Permitting plaintiff to take advantage of this windfall would also detract from treating foreign branches and

foreign subsidiaries similarly for purposes of the section 902 credit. In its General Statement adopting the Revenue Act of 1962, which amended both section 78 and section 902, the Senate stated:

> The remaining provisions in the bill (which included sections 78 and 902) are concerned primarily with improving tax equity and eliminating tax evasion and avoidance, either in the domestic economy or with respect to income earned abroad by American interests. In the latter case, the primary concern . . . has been with the removal of special tax advantages accruing to 'tax havens.'

S. Rep. No. 1881, 87th Cong., 2d Sess. 1, *reprinted in* 1962 U.S. Code Cong. & Admin. News 3304. Absent the amendments to section 78 by the Revenue Act of 1962, the entire income of a foreign branch would be treated as taxable income by both the United States and the foreign country, while only the distributed after-tax income of a foreign subsidiary would be treated as taxable income by the United States. Treating the foreign subsidiary in the instant case similarly to a foreign branch eliminates tax evasion and avoidance accruing to the foreign corporate "tax haven" without subjecting the subsidiary to double taxation.

C. Administrative Interpretation

Treasury Regulation 1.902-3(c)(1) states that "[a]ccumulated profits for any taxable year of a first-tier corporation which is not a less developed country corporation . . . shall . . . be the sum of (i) the earnings and profits of such corporation for such year, and (ii) the foreign income taxes imposed on or with respect to the gains, profits and income to which such earnings and profits are attributable." 26 C.F.R. § 1.902-3(c)(1) (1965). This regulation clearly distinguishes "earnings and profits"

from "gains, profits and income." The relation of "gains, profits and income" to foreign income taxes indicates this tax concept is to be equated with foreign taxable income. "Earnings and profits," on the other hand, appear in this instance to refer to income which would be subject to United States tax. *Cf. Champion Int'l*, 81 T.C. at 447.[8] This regulation is an attempt to recoup, for purposes of section 902, income that would otherwise escape taxation in both the foreign country and the United States. The regulation is consistent with the purposes enunciated by Congress when enacting the indirect tax credit legislation and further supports the court's decision.

II. Application of Section 905

Plaintiff contended that in the event United States tax law concepts are deemed to be controlling for purposes of section 902, the payments from the British government to the foreign subsidiary during 1975 and 1976 were not the type of payments referred to as refunds in section 905 and

[8] Computing "earnings and profits" in accordance with United States tax law in this instance dispels the plaintiff's "sourcing" arguments and preserves the Tax Court's ruling in *H. H. Robertson Co. v. Commissioner of Internal Revenue*, 59 T.C. 53 (1972), *aff'd by memorandum*, 500 F.2d 1399 (3rd Cir. 1984), that accumulated profits is an annual computation while earnings and profits is an aggregate computation of a corporation's undistributed realized profits. Although earnings and profits is an aggregate concept, for foreign tax credit purposes it is, in effect, an annual computation since the regulation mandates only those earnings and profits attributable to foreign taxable income for the given year are to be considered when computing the indirect foreign tax credit. Thus, although a foreign subsidiary's accumulated profits initially has as its basis a computation based on earnings and profits, adjustments required by the regulation apportion this aggregate amount to the particular year(s) in question making the initial aggregate computation ultimately an annual computation.

are, therefore, not within the reach of the Commission's 905 recomputation powers. Plaintiff argued that since the language of the section 905 has not changed from that of its predecessor, section 252 of the Revenue Act of 1918, the term "refund" must be interpreted consistently with its original meanings, *i.e.*, the term applies only to refunds of incorrect foreign taxes and the subsequent event of a net operating loss does not disturb an earlier credit granted for a foreign tax which was correct when paid. Thus, according to plaintiff, the Commissioner of Internal Revenue acted without authority when he directed the section 902(a)(1) tax credits claimed by plaintiff on its 1970 and 1971 United States income tax returns be recomputed. Plaintiff's reasoning, however, is inapposite with both the expressed language of the statute and rules of statutory interpretation.

The plain and unambiguous language of section 905(c) states that "if any tax paid is refunded in whole or part, the taxpayer shall notify the Secretary or his delegate, who shall redetermine the amount of the tax for the year or years affected." 26 U.S.C. S 905(c). The duty of interpretation does not arise when statutory language is unambiguous. *E.g., American Tobacco Co. v. Patterson*, 456 U.S. 63, 68 (1982). In such cases, words in the statute are considered to be used in their ordinary and usual sense. *Old Colony R.R. Co. v. Commissioner of Internal Revenue*, 284 U.S. 552, 560 (1932); *Hine v. United States*, 113 F.Supp. 340, 343, 125 Ct. Cl. 836, 841 (1953); *Fordyce v. United States*, 7 Cl. Ct. 591, 596 (1985). The court agrees with defendant that the reason for the refund is immaterial. What is significant is that a tax refund was paid to, and received by, plaintiff's subsidiary. The statutory term "refund" when construed in its ordinary and usual sense includes repayment of tax dollars stemming from a subsequent net operating loss. The court would be hard-

pressed to find any repayment of tax dollars to not be a refund as the term is used. Indeed, to hold as plaintiff urged, that Congress must be held to assent only to those definitions afforded to a term at the term the original statute incorporating that term was enacted, would produce results contrary to the unmistakable purposes Congress had in mind when enacting the indirect tax credit legislation.

As the court previously discussed, permitting plaintiff an indirect tax credit for taxes its foreign subsidiary did not in fact pay would go well beyond the legislation's purpose of preventing double taxation and would frustrate the purposes of treating a foreign subsidiary similary to a foreign branch of a domestic corporation and limiting the amount of foreign tax credit a domestic corporation is permitted to claim. The court holds instead that the payments to Goodyear England during 1975 and 1976 were refunds as that term is used in section 905 and, therefore, the Commissioner of Internal Revenue did act properly when he directed the section 902(a)(1) credits claimed by plaintiff on its 1970 and 1971 United States income tax returns be recomputed.

CONCLUSION

For the foregoing reasons, the court finds that plaintiff is entitled to no tax refund as a result of the recomputations to its 1970 and 1971 United States income taxes ordered by the Commissioner of Internal Revenue. Plaintiff's motion for summary judgment is denied and defendant's motion for summary judgment is granted. The Clerk is ordered to enter judgment in favor of defendant and to dismiss the complaint.

IT IS SO ORDERED.

/s/ M. R. Tidwell
MOODY R. TIDWELL
Judge

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

No. 88-1201

THE GOODYEAR TIRE & RUBBER COMPANY AND AFFILIATES, PLAINTIFF-APPELLANT

v.

THE UNITED STATES, DEFENDANT-APPELLEE

[Entered Aug. 31, 1988]

Judgment

ON APPEALS from the United States Claims Court in Case No(s). 510-85 T

This CAUSE having been heard and considered, it is ORDERED AND ADJUDGED:

REVERSED

ENTERED BY ORDER
OF THE COURT

AUG 31, 1988 /s/ FRANCIS X. GINDHART
Francis X. Gindhart, Clerk

ISSUED AS A MANDATE: NOV. 15, 1988

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

No. 88-1201

THE GOODYEAR TIRE & RUBBER COMPANY AND AFFILIATES,
PLAINTIFF-APPELLANT

v.

THE UNITED STATES, DEFENDANT-APPELLEE

[Filed Dec. 28, 1988]

Order

A suggestion for rehearing in banc having been filed in this case, and a re[s]ponse thereto having been invited by the court and filed,

UPON CONSIDERATION THEREOF, it is

ORDERED that the suggestion for rehearing in banc be, and the same is, declined

Judge Archer would rehear the case in banc.

FOR THE COURT

December 28, 1988 /s/ FRANCIS X. GINDHART
Francis X. Gindhart, Clerk

APPENDIX E

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

No. 88-1201

THE GOODYEAR TIRE & RUBBER COMPANY AND AFFILIATES,
PLAINTIFF-APPELLANT

v.

THE UNITED STATES, DEFENDANT-APPELLEE

Before NEWMAN and BISSELL, Circuit Judges and RE, Chief Judge.*

[Filed Nov. 10, 1988]

Order

A petition for rehearing having been filed in this case,

UPON CONSIDERATION THEREOF, it is

ORDERED that the petition for rehearing be, and same hereby is, denied.

The suggestion for rehearing in banc is under consideration.

FOR THE COURT

11/8/88 /s/ FRANCIS X. GINDHART
Francis X. Gindhart, Clerk

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* The Honorable Edward D. Re, Chief Judge, U.S. Court of International Trade, sitting by designation pursuant to 28 U.S.C. § 293(a).

APPENDIX F

The Internal Revenue Code of 1954 (26 U.S.C.), as in effect for the years 1970 and 1971, provided in pertinent part:

§ 316. Dividend defined.

(a) General rule.

For purposes of this subtitle, the term "dividend" means any distribution of property made by a corporation to its shareholders—

(1) out of its earnings and profits accumulated after February 28, 1913, or

(2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

§ 901. Taxes of foreign countries and of possessions of United States.

(a) Allowance of credit.

If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall, subject to the applicable limitation of section 904, be credited with the amounts provided in the applicable paragraph of subsection (b) plus, in the case of a corporation, the taxes deemed to have been paid under sections 902 and 960. Such choice for any taxable year may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by this chapter for such taxable year. The credit shall not be allowed against the tax imposed by section 56 (relating

to minimum tax for tax preferences), against the tax imposed by section 531 (relating to the tax on accumulated earnings), against the additional tax imposed for the taxable year under section 1333 (relating to war loss recoveries) or under section 1351 (relating to recoveries of foreign expropriation losses), or against the personal holding company tax imposed by section 541.

(b) Amount allowed.

Subject to the applicable limitation of section 904, the following amounts shall be allowed as the credit under subsection (a):

(1) Citizens and domestic corporations.

In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; * * *

§ 902. Credit for corporation stockholder in foreign corporation.

(a) Treatment of taxes paid by foreign corporation.

For purposes of this subpart, a domestic corporation which owns at least 10 percent of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall—

(1) to the extent such dividends are paid by such foreign corporation out of accumulated profits (as defined in subsection (c)(1)(A)) of a year for which such foreign corporation is not a less developed country corporation, be deemed to have paid the same proportion of any income, war profits, or excess profits taxes paid or deemed to be paid by such foreign corporation to any foreign country or to any pos-

session of the United States on or with respect to such accumulated profits, which the amount of such dividends (determined without regard to section 78) bears to the amount of such accumulated profits in excess of such income, war profits, and excess profits taxes (other than those deemed paid); * * *

* * * * *

(c) Applicable rules.

(1) Accumulated profits defined.

For purposes of this section, the term "accumulated profits" means with respect to any foreign corporation—

(A) for purposes of subsections (a)(1), (b)(1)(A), and (b)(2)(A), the amount of its gains, profits, or income computed without reduction by the amount of the income, war profits, and excess profits taxes imposed on or with respect to such profits or income by any foreign country or any possession of the United States; and

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The Secretary or his delegate shall have full power to determine from the accumulated profits of what year or years such dividends were paid, treating dividends paid in the first 60 days of any year as having been paid from the accumulated profits of the preceding year or years (unless to his satisfaction shown otherwise), and in other respects treating dividends as having been paid from the most recently accumulated gains, profits, or earnings.

The Treasury Regulations on Income Tax (26 C.F.R.), as in effect in 1970 and 1971, provided in pertinent part:

§ 1.902-3 Credit for domestic corporate shareholder of a foreign corporation (after amendment by Revenue Act of 1962).

* * * * *

(c) Determination of accumulated profits and taxes paid on or with respect thereto—(1) First-tier corporation which is not a less developed country corporation. The accumulated profits for any taxable year of a first-tier corporation which is not a less developed country corporation, as defined in § 1.902-4, for such year shall in accordance with section 902(c)(1)(A), be the sum of—

(i) The earnings and profits of such corporation for such year, and

(ii) The foreign income taxes imposed on or with respect to the gains, profits, and income to which such earnings and profits are attributable.

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